

United States 18  
**Circuit Court of Appeals**  
For the Ninth Circuit.

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COMMISSIONER OF INTERNAL REVENUE,  
Petitioner,

vs.

COLUMBIA NATIONAL BANK, a corporation,  
Respondent.

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**Transcript of the Record**

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Upon Petition to Review a Decision of the United States  
Board of Tax Appeals

FILED

AUG 24 1942

PAUL F. O'BRIEN,



United States  
Circuit Court of Appeals  
For the Ninth Circuit.

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COMMISSIONER OF INTERNAL REVENUE,  
Petitioner,

vs.

COLUMBIA NATIONAL BANK, a corporation,  
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Upon Petition to Review a Decision of the United States  
Board of Tax Appeals



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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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## APPEARANCES

For Taxpayer :

HENRY F. MOORE, C. P. A.

JOHN F. WATSON, Esq.,

THOMAS P. GOSE, Esq.;

For Commissioner :

E. M. WOOLF, Esq.,

ALVA C. BAIRD, Esq.

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Docket No. 106404

COLUMBIA NATIONAL BANK,  
DAYTON, WASHINGTON,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

## DOCKET ENTRIES

1941

Feb. 10—Petition received and filed. Taxpayer notified. Fee paid.

Feb. 10—Copy of petition served on General Counsel.

Mar. 12—Motion to dismiss (Rule 6) filed by General Counsel.

Mar. 14—Hearing set April 9, 1941 on motion.

Mar. 22—Motion for leave to file amended petition filed by taxpayer.

1941

- Apr. 4—Amended petition filed by taxpayer. 4/5/41 copy served.
- Apr. 9—Hearing had before Mr. Arundell on motion of respondent to dismiss. Amended petition objected to by respondent. Four weeks to file a further amended petition to include facts, etc.
- Apr. 9—Order that proceeding be continued to the Washington, D. C. calendar of 5/7/41 for further hearing upon respondent's motion to dismiss with leave to the petitioner to file within that time a second amended petition prepared in accordance with the Board's rules entered.
- Apr. 28—Second amended petition filed by taxpayer. 4/29/41 copy served.
- Apr. 28—Request for Circuit hearing in Seattle. Washington filed by taxpayer. 4/28/41 copy served.
- Apr. 28—Notice to serve further papers on John F. Watson filed by Henry F. Moore.
- May 6—Notice of the appearance of John F. Watson as counsel filed.
- May 7—Hearing had before Mr. Arundell on motion of respondent to dismiss. Denied (Second amended petition). Usual time to answer.
- May 7—Order that respondent's motion to dismiss be denied and respondent be allowed 60 days to answer or 45 days to move. entered.



1941

- Jun. 3—Answer to second amended petition filed by General Counsel.
- Jun. 5—Copy of answer to second amended petition served on taxpayer.
- Jul. 22—Hearing set Sept. 8, 1941 in Seattle, Washington.
- Aug. 20—Amended application for subpoena of the respondent filed by taxpayer.
- Aug. 20—Subpoena duces tecum to Guy T. Helvering issued.
- Sep. 9—Hearing had before Mr. Sternhagen on merits. Stipulation of facts filed. Appearance of Thomas P. Gose filed. Petitioner's brief due in 30 days—respondent 30 days for reply—petitioner 15 days for reply.
- Sep. 27—Transcript of hearing of 9/9/41 filed.
- Oct. 6—Brief filed by taxpayer. 10/6/41 copy served.
- Nov. 8—Brief filed by General Counsel. 11/10/41 copy served. Mimeograph copies received 11/27/41. (Copy served)
- Nov. 24—Reply brief filed by taxpayer. 11/24/41 copy served. [1\*]

1942

- Jan. 29—Memorandum opinion rendered, Sternhagen. #10. Decision will be entered under Rule 50. 1/29/41 copy served.

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\*Page numbering appearing at top of page of original certified Transcript of Record.

1942

- Feb. 6—Computation of deficiency filed by taxpayer.
- Feb. 9—Hearing set March 11, 1942 on settlement.
- Feb. 9—Copy of recomputation and notice of hearing served on General Counsel.
- Feb. 24—Computation of deficiency filed by General Counsel.
- Feb. 26—Decision entered, Sternhagen, Div. 10.
- May 15—Petition for review by U. S. Circuit Court of Appeals, 9th Circuit with assignments of error filed by General Counsel.
- May 23—Proofs of service filed by General Counsel. (4).
- Jun. 8—Statement of points filed by General Counsel with proof of service thereon.
- Jun. 8—Designation of parts of record to be included in record on review filed by General Counsel with proof of service thereon.
- Jun. 8—Agreed statement of evidence filed. [2]

United States Board of Tax Appeals  
Docket No. 106404.

COLUMBIA NATIONAL BANK,  
Dayton, Washington,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

SECOND AMENDED PETITION

The above-named Petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (Bureau Symbols IT:90D:JW), dated November 22, 1940, and as a basis of its proceeding alleges as follows:

1. The Petitioner is a corporation organized under The National Bank Act with its place of business at Dayton, Washington. The return for the period here involved was filed with the Collector for the District of Washington.

2. The notice of deficiency (a copy of which is attached and marked "Exhibit A") was mailed to the Petitioner on November 22, 1940.

3. The taxes in controversy are income taxes for the calendar year 1939 and in the amount of \$1,921.92.

4. The determination of tax set forth in the said notice of deficiency is based upon the following error:

(a) In determining the tax liability of the Petitioner for the year 1939, the Commissioner in error treats as taxable income an item representing the recovery of bad debts written off in prior years in the amount of \$11,568.39.

5. The facts upon which the Petitioner relies as the basis of this proceeding are as follows: [3]

(a) This Petitioner filed in the office of the Collector of Internal Revenue at Tacoma, Washington, a timely income tax return, form 1120, for the calendar year ended December 31, 1939, a net loss in the amount of \$920.36, being shown thereby.

(b) As a result of an examination of the said return for the year ended December 31, 1939, by an Internal Revenue Agent, per report dated May 16, 1940, this Petitioner was advised by the Internal Revenue Agent in Charge at Seattle, Washington, under date of October 15, 1940, (Reference, 2240-W) of a deficiency of \$1921.19, in income tax for the said year 1939.

(c) Under date of November 22, 1940, (Bureau Symbols IT:90D:JW) the Commissioner by Geo. C. Earley, Internal Revenue Agent in Charge at Seattle, Washington, advised this Petitioner that a determination of Petitioner's income tax liability for the taxable year ending December 31, 1939, disclosed a deficiency in income tax for the said year 1939 in the amount of \$1,921.92, and that Petitioner had 90 days

from the date of mailing of said letter within which to file a petition with the United States Board of Tax Appeals for a redetermination of said deficiency. Said 90 day letter, with Statement therein referred to, being hereto attached marked "Exhibit A" (pages 1, 2 and 3), and made a part of this paragraph as fully for all intents and purposes as if herein set forth verbatim, and within said time limit, Petitioner's original petition was filed with the United States Board of Tax Appeals in this proceeding.

(d) The alleged deficiency shown in said ninety-day letter is based upon the inclusion as taxable income for the taxable year 1939 of \$11,568.39 recovered during said year on bad debts charged off in prior years. Hereto attached Marked "Exhibit B", and by reference made a part of this paragraph as fully for all intents and purposes as if herein set forth verbatim, is an itemized list of said bad debts recovered during the taxable year 1939, showing fully the facts pertaining to each item. Petitioner in its income tax returns for each of the years for which said various items respectively were charged off reported same as deductions but had no tax benefit therefrom by reason of there being no taxable net income for that year, regardless of said deductions. Each of the several items shown on said Exhibit was by Petitioner in good faith determined to be worthless



and uncollectible during the year same was charged off as shown by said exhibit, and Petitioner alleges that none of said recoveries constitutes taxable income for the taxable year 1939 or any other [4] year, and that the Commissioner is in error in including any of said recoveries as taxable income for the taxable year 1939.

Wherefore, the Petitioner prays that this Board may hear the proceeding and redetermine the tax liability of this Petitioner on the basis of the elimination from income for the said year of the said bad debt recoveries in the amount of \$11,568.39.

(Signed) HENRY F. MOORE (C.P.A.)

Counsel for Petitioner,  
809 Hoge Building,  
Seattle, Washington.

(Signed) JOHN F. WATSON

Counsel for Petitioner,  
218 First National Bank  
Building,  
Walla Walla, Washington.

(Duly verified.) [5]

EXHIBIT "A"

No. 2240-W

Page 1.

TREASURY DEPARTMENT

Internal Revenue Service

Seattle, Washington

November 22, 1940

Office of

Internal Revenue Agent in Charge

Seattle Division

350 Federal Office Building

IT:90D:JW

Columbia National Bank,

Dayton, Washington.

Sirs:

You are advised that the determination of your income tax liability for the taxable year(s) ended December 31, 1939, discloses a deficiency of \$1,921.92 as shown in the statement attached.

In accordance with the provisions of existing Internal Revenue Laws, notice is hereby given of the deficiency mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to Internal Revenue Agent in Charge, Seattle,

Washington, for the attention of IT:90D:JW. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

GUY T. HELVERING,

Commissioner.

By GEO. C. EARLEY,

Internal Revenue Agent in  
Charge

Enclosures:

Statement.

Form of Waiver.

JW-ah [6]

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## STATEMENT

IT:90D:JW

Columbia National Bank,  
Dayton, Washington.

Tax liability for the taxable year ended December 31, 1939.

	Liability	Assessed	Deficiency
Income Tax .....	\$1,921.92	None	\$1,921.92

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated May 16, 1940.



A copy of this letter and statement has been mailed to your representative, Henry F. Moore, 809 Hoge Building, Seattle, Washington, in accordance with the authority contained in the Power of Attorney executed by you and on file with the Bureau.

#### Adjustments to Net Income

Net loss as disclosed by return.....		(\$ 920.36)
Unallowable deductions and additional income:		
(a) Recovery of Bad Debts.....	\$11,568.39	
(b) Mark-down of Furniture and Fixtures .....	1,000.00	
(c) Interest on U. S. Bonds.....	1,943.29	14,511.68
Net income adjusted .....		<u>\$13,591.32</u>

### EXPLANATION OF ADJUSTMENTS

(a) Recoveries on debts previously charged off your books as uncollectible were realized in the amount of \$11,568.39, but on your return this amount was treated as nontaxable income. It is held that the entire amount of such recoveries represented taxable income.

(b) There was deducted on your return \$1,000.00 that was explained under Schedule M as "Write off on Furniture & Fixtures (Examiner's Request), \$1000.00".

Since the cost of such assets is recoverable under allowances for depreciation, the extra charge-off is not allowable. [7]

(c) Interest on U. S. Bonds is subject to excess-profits tax, but since the credit exceeds the net income for excess-profits tax computation, this adjustment does not affect your total tax liability.

## COMPUTATION OF TAX

## EXCESS-PROFITS TAX

No excess-profits tax assessable or assessed:

Exemption, \$20,101.96.

## INCOME TAX COMPUTATION

## Tax on Special Classes of Corporations

Net income for excess-profits computation.....\$13,591.32

Less:

Excess-profits Tax ..... none

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Net income ..... 13,591.32

Less:

Interest on obligations of the United States, etc... 1,943.29

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Adjusted net income ..... 11,648.03

Special class net income.....\$11,648.03

## Corporations Not Subject to Graduated Income Tax Rates

National Bank

		Rate	
(Income tax assessable)....	\$11,648.03	16½%	1,921.92

Income Tax Assessed:

Original, Account No. 850086 ..... none

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Deficiency of Income Tax..... \$1,921.92

## EXHIBIT B

Bad Debt Recoveries by Columbia National Bank of Dayton, Washington,  
During the Taxable Year 1939.

Name and Address of Debtor.	Amount of Debt Originally Charged off.	Year in Which Charged off and Reasons Therefor.	Amount Recovered, 1939
C. N. Seeley, Dayton, Washington.	\$1,000.00	1930—Determined to be worthless and uncollectible.	\$ 500.11
G. N. Gosney, Dayton, Washington.	3,000.00	1930— “ “	\$ 2,451.25
W. B. Ingram, Dayton, Washington.	4,500.00	1930— “ “	\$ 1,435.00
Joe Rose, Dayton, Washington.	2,000.00	1930— “ “	281.56
Remie, De Ruwe, Dayton, Washington	10,000.00	1930— “ “	3,001.28
Edna Chandler, Dayton, Washington.	4,600.00	1934— “ “	45.03
Fred McCauley, Dayton, Washington.	1,375.00	1934— “ “	100.00
Lindsey Magill, Dayton, Washington.	1,100.00	1934— “ “	100.00
Ray E. Gaines, Dayton, Washington.	2,200.00	1934— “ “	1,267.58
E. G. Harsh, Dayton, Washington.	260.00	1935— “ “	25.00
Hannah Fanscher, Spokane, Washington.	9,240.00	1936— “ “	496.52
B. N. Bessett, Dayton, Washington.	3,443.00	1936— “ “	791.06
Earl Winnett, Dayton, Washington.	35.00	1936— “ “	4.00
			[9]
Oren Jones, Dayton, Washington.	\$ 1,000.00	1937— “ “	\$ 1,000.00
Knud Paulsen, Dayton, Washington.	70.00	1937— “ “	70.00
Totals.....	\$43,823.00		\$11,568.39

[Endorsed]: U.S.B.T.A Filed Apr. 28, 1941. [10]

[Title of Board and Cause.]

## ANSWER TO SECOND AMENDED PETITION

Comes now the Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the second amended petition filed herein, admits and denies as follows:

1. Admits the allegations contained in paragraph 1 of the second amended petition.

2. Admits the allegations contained in paragraph 2 of the second amended petition.

3. Admits the allegations contained in paragraph 3 of the second amended petition.

4. Denies that he erred in his determination of the deficiency as shown by the notice of deficiency from which the petitioner's appeal is taken. Specifically denies that he erred in the manner and form as alleged in paragraph 4(a) of the second amended petition. [11]

5. (a), (b) and (c). Admits the allegations contained in subparagraphs (a), (b) and (c) of paragraph 5 of the second amended petition.

(d). Admits that the deficiency shown in said 90-day letter is based upon the inclusion as taxable income for the taxable year 1939 of \$11,568.39 recovered during said year on bad debts charged off in prior years. Denies the remaining allegations contained in subparagraph (d) of paragraph 5 of the second amended petition.

6. Denies generally and specifically each and

every material allegation contained in the second amended petition herein, not hereinbefore specifically admitted, qualified, or denied.

Wherefore, it is prayed that the petitioner's appeal be denied and that the Commissioner's determination of deficiency be approved.

(Signed) J. P. WENCHEL

JHP

Chief Counsel,  
Bureau of Internal Revenue.

Of Counsel:

ALVA C. BAIRD,  
Division Counsel.

JOHN H. PIGG,  
Special Attorney,  
Bureau of Internal Revenue.

[Endorsed]: U.S.B.T.A. Filed Jun. 3, 1941. [12]

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[Title of Board and Cause.]

### STIPULATION OF FACTS

It is hereby stipulated that for the purposes of this proceeding the United States Board of Tax Appeals may consider as true the following:

#### I.

The above named Petitioner, as shown by its fed-

eral income tax returns to be introduced in evidence herein, had net losses as follows:

For 1930 a net loss of.....	\$ 43,634.92
“ 1931 “ “ “ “.....	12,620.33
“ 1934 “ “ “ “.....	89,529.75
“ 1935 “ “ “ “.....	7,487.59
“ 1936 “ “ “ “.....	3,758.83
“ 1937 “ “ “ “.....	12,621.71
<hr/>	
Total.....	\$169,653.13

## II.

In each of said years Petitioner charged off bad debts as follows:

In 1930 charged off.....	\$ 98,674.20
“ 1931 “ “.....	57,809.73
” 1934 “ “.....	91,394.63
“ 1935 “ “.....	17,968.90
“ 1936 “ “.....	26,889.70
“ 1937 “ “.....	31,705.87
<hr/>	
Total.....	\$324,443.03

[13]

## III.

In 1939 Petitioner made recoveries upon said bad debts as follows:

Of bad debts charged off in 1930 recovered.....	\$ 7,699.20
“ “ “ “ “ “ 1934 “.....	1,512.61
“ “ “ “ “ “ 1935 “.....	25.00
“ “ “ “ “ “ 1936 “.....	1,291.58
“ “ “ “ “ “ 1937 “.....	1,070.00
<hr/>	
Total.....	\$11,568.39

## IV.

The particular debts previously charged off by Petitioner, and upon which recoveries were made



in 1939, and the authority for such charge-offs are correctly set forth and shown in Schedule "A" hereto attached.

## V.

Petitioner for each of the years from 1930 to 1939, inclusive, kept its books of account, made its Federal income tax returns and paid its income taxes, if any, on a cash basis, and not on an accrual basis.

## VI.

It is agreed that the facts stipulated herein are for the purposes of this case only and are not to be binding on either party hereto in any controversy now pending or which may hereafter arise in respect to tax liability other than that involved in this proceeding.

Dated this 8th day of September, A. D., 1941.

JOHN F. WATSON

Of Counsel for Petitioner  
218 First National Bank Bldg.  
Walla Walla, Washington

(S) J. P. WENCHEL

Chief Counsel  
Bureau of Internal Revenue

[14]





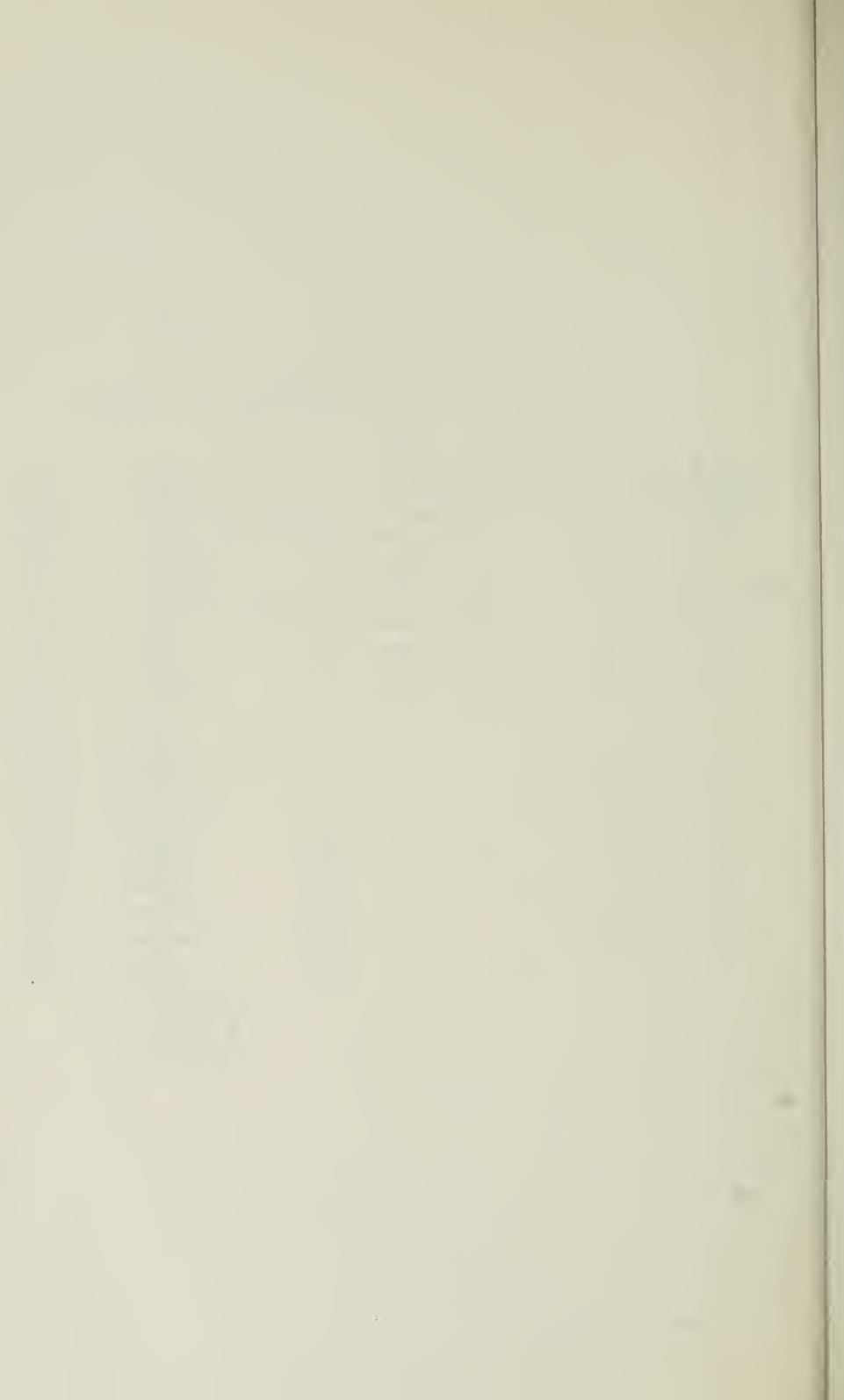
Name and Address of Debtor	Amount of Debt Originally Charged Off
C. N. Seely, Dayton, Wash.....	\$ 1,000.00
G. N. Gosney, Dayton, Wash.....	3,000.00
W. B. Ingram	{ 2,500.00
Dayton, Washington .....	{ 2,000.00
Joe, Rose, Dayton, Wash.....	2,000.00
Remie DeRuwe, Dayton, Wash.....	10,000.00
Edna Chandler, Dayton, Wash.....	4,600.00
Fred McCauley, Dayton, Wash.....	1,375.00
Lindsey Magill, Dayton, Wash.....	1,100.00
Ray E. Gaines, Dayton, Wash.....	2,200.00
E. G. Harsh, Dayton, Wash.....	260.00
Hannah Fanseher, Spokane, Wash.....	9,240.00
B. N. Bessett, Dayton, Wash.....	3,443.00
Earl Winnett, Dayton, Wash.....	35.00
Oren Jones, Dayton, Wash.....	1,000.00
Knud Paulsen, Dayton, Wash.....	70.00
Total.....	<u>\$43,823.00</u>

[Endorsed]: U.S.B.T.A. Sep. 9, 1941. [15]

SCHEDULE "A"  
Columbia National Bank of Dayton, Washington  
Docket No. 106,404

Year in Which Charged Off	Determined Uncollectible Within The Year of Charge-off by	Date of Examiner's Report
1930	National Bank Examiner	Oct. 2, 1930
1930	Do.	Oct. 2, 1930
1930	Comptroller of the Currency	
1930	National Bank Examiner	Oct. 2, 1930
1930	Do.	Oct. 2, 1930
1930	Do.	Oct. 2, 1930
1934	Do.	Feb. 6, 1934
1934	Do.	Do.
1934	Do.	Nov. 13, 1934
1934	Do.	Feb. 6, 1934
1935	Do.	Dec. 11, 1935
1936	Do.	Oct. 20, 1936
1936	Do.	Oct. 20, 1936
1936	Do.	Oct. 20, 1936
1937	Do.	Dec. 15, 1937
1937	Do.	Dec. 15, 1937

Date of Comptroller's Letter	Date Charge-off Authorized in Minutes	Amount Recovered in 1939
	Oct. 7, 1930	\$ 500.11
	Oct. 7, 1930	2,451.25
July 9, 1930	Aug. 5, 1930	900.00
	Oct. 7, 1930	535.00
	Oct. 7, 1930	281.56
	Oct. 7, 1930	3,001.28
		45.03
		100.00
		100.00
		1,267.58
		25.00
		496.52
		791.06
		4.00
		1,000.00
		70.00
		<hr/>
		<u>\$11,568.39</u>



[Title of Board and Cause.]

MEMORANDUM OPINION.

Sternhagen :

The Commissioner determined a deficiency of \$1,921.92 in petitioner's income tax for 1939. He included in petitioner's income the amount of recoveries of debts which had in earlier years been charged off and deducted. The facts are stipulated, and they are so found. The question is the same as has been considered by the Board in earlier cases, and it needs no exposition.

In 1939, petitioner recovered \$11,568.39 of debts which had been charged off in 1930, 1934, 1935, 1936, and 1937. In the years when the debts were charged off, other debts had been charged off also. The total amount of debts charged off in each year was greater than the amount of net loss sustained in that year, including the charge-off for debts in the computation of net loss. The taxpayer regards the recoveries in 1939 as amounts of which it had not taken a deduction or otherwise received a "tax benefit" in the year of charge-off. For that reason it excluded the recoveries from its gross income. This is in accord with *Central Loan & Investment Co.*, 39 B.T.A. 981; *National Bank of Commerce of Seattle*, 40 B.T.A. 72, affirmed 115 Fed. (2d) 875; *American Dental Co.*, 44 B.T.A. 425, (on review C.C.A. 7); *Amsco-Wire Products Corporation*, 44 B.T.A. 720; *Hurd Millwork Corporation*, 44 B.T.A. 786, 791; *State-Planters Bank & Trust Co.*, 45 B.T.A.

630; and contrary to Stearns Coal & Lumber Co. v. Glenn, — Fed. Supp. — (D.C. Ky., Dec. 5, 1941).

The determination is reversed.

Decision will be entered under Rule 50.

[Seal]

Entered: January 29, 1942. [16]

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United States Board of Tax Appeals  
Washington

Docket No. 106404

COLUMBIA NATIONAL BANK,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

DECISION

Subsequent to the Board's Memorandum Opinion, entered January 29, 1942, the parties filed computations which agree as to the amount of the deficiency. In accordance therewith, it is

Ordered and Decided that there is a deficiency of \$13.14 in income tax for 1939.

Enter:

[Seal]            (s) J. M. STERNHAGEN,  
Member.

Entered Feb. 26, 1942. [17]

In the United States Circuit Court of Appeals  
for the Ninth Circuit

B.T.A. Docket No. 106404

GUY T. HELVERING,

Commissioner of Internal Revenue,

Petitioner on Review,

v.

COLUMBIA NATIONAL BANK,

Respondent on Review.

PETITION FOR REVIEW AND  
ASSIGNMENTS OF ERROR

To the Honorable Judges of the United States Circuit Court of Appeals for the Ninth Circuit:

Now Comes Guy T. Helvering, Commissioner of Internal Revenue, by his attorneys, Samuel O. Clark, Jr., Assistant Attorney General, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and John W. Smith, Special Attorney, Bureau of Internal Revenue, and respectfully shows:

I.

JURISDICTION

That the petitioner on review, hereinafter referred to as the Commissioner, is the duly appointed, qualified, and Acting Commissioner of Internal Revenue, holding his office by virtue of the laws of the United States; that the respondent on review, Co-

lumbia National Bank, hereinafter referred to as the taxpayer, is a corporation organized August 15, 1882, under the Banking laws of the United States, with its principal place of business at Dayton, Washington.

That the taxpayer executed and filed its corporation income and excess-profits tax return for the calendar year 1939 with the Collector [18] of Internal Revenue for the District of Washington, Tacoma, Washington, whose office is within the jurisdiction of this Honorable Court; that the Court in which the review of this cause is sought is the United States Circuit Court of Appeals for the Ninth Circuit.

The Commissioner files this petition for review pursuant to the provisions of Sections 1141 and 1142 of the Internal Revenue Code.

## II.

### NATURE OF CONTROVERSY

The nature of the controversy is as follows, to-wit:

During the calendar year 1939, taxpayer recovered \$11,568.39 on certain debts which it had charged off in 1930 and 1934 to 1937, inclusive, and taken deductions therefor in determining net taxable income for said years. The total amount of bad debt deductions was greater than the amount of the net loss sustained in said years.

The taxpayer, in its 1939 tax return, treated the amount of \$11,568.39 as nontaxable income.

On November 22, 1940, the Commissioner mailed



to the taxpayer a notice of deficiency in income tax for the year 1939 in the amount of \$1,921.92. In arriving at said deficiency the Commissioner increased the reported net income by three additions, the principal one being \$11,568.39 for recovery of bad debts, determining that such amount constituted taxable income for the year of recovery.

On February 10, 1941, the taxpayer filed a petition with the United States Board of Tax Appeals challenging the Commissioner's determination [19] set forth in his notice of deficiency. On April 4, 1941, taxpayer filed an amended petition and on April 28, 1941, filed its second amended petition. The taxpayer alleged in each petition that the Commissioner had erred in treating as taxable income the recoveries received in the year 1939, aggregating \$11,568.39. On June 3, 1941, the Commissioner filed his answer to the second amended petition.

The proceeding came on for hearing September 9, 1941, before a Division of the Board at Seattle, Washington. On January 29, 1942, the Board entered its memorandum opinion wherein it upheld the taxpayer's contention that it had not received a "tax benefit" in the year of charge-off and, therefore, the recoveries during the year 1939 of debts previously charged off, amounting to \$11,568.39, do not constitute taxable income for said year.

On February 26, 1942, the Board entered its decision wherein and whereby it ordered and decided that there is a deficiency of \$13.14 in income tax for 1939. [The deficiency is due to other adjust-

ments made by Commissioner not contested by the taxpayer.

### III.

#### ASSIGNMENTS OF ERROR

The Commissioner being aggrieved by the conclusions of law contained in the opinion of the United States Board of Tax Appeals and by its decision redetermining there is a deficiency of only \$13.14 in income tax for the calendar year 1939 desires to obtain a review by the United States Circuit Court of Appeals for the Ninth Circuit.

The Commissioner's assignments of error are as follow: [20]

The Board of Tax Appeals erred:

1. In holding and deciding that no part of \$11,568.39 recovered by the taxpayer in 1939 on account of bad debt losses claimed and allowed as deductions from gross income in determining income tax liabilities for prior years should be included in the taxpayer's gross income for such year.

2. In failing to hold and decide that the amount of \$11,568.39 recovered by the taxpayer in 1939 on account of bad debt losses claimed and allowed as deductions from gross income in determining income tax liabilities for prior years constituted taxable income for the calendar year 1939.

3. In entering its decision wherein it ordered and decided that there is a deficiency in income tax due from this taxpayer of only \$13.14 for the calendar year 1939.

4. In failing and refusing to enter its decision redetermining that there is a deficiency in income tax in the amount of \$1,921.92 for the calendar year 1939.

5. In that its decision is not supported by the evidence.

6. In that its decision is contrary to law and regulations.

Wherefore, the Commissioner petitions that the decision of the Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the Ninth Circuit, that a transcript of record be prepared in accordance with the rules of said Court and transmitted to the Clerk of said Court [21] for filing, and that proper action be taken to the end that the errors complained of may be reviewed by said Court.

(Sgd.) SAMUEL O. CLARK, JR.

Assistant Attorney General

(Signed) J. P. WENCHEL

RLW

Chief Counsel,

Bureau of Internal Revenue,

Counsel for Petitioner on

Review.

Of Counsel:

JOHN W. SMITH,

Special Attorney,

Bureau of Internal Revenue.

JWS:br 4-17-42

[Endorsed]: U.S.B.T.A. Filed May 15, 1942. [22]

[Title of Circuit Court of Appeals and Cause.]

NOTICE OF FILING PETITION FOR  
REVIEW

To: Columbia National Bank,  
Dayton, Washington.

You are hereby notified that the Commissioner of Internal Revenue did, on the 15th day of May, 1942, file with the Clerk of the United States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Ninth Circuit, of the decision of the Board heretofore rendered in the above-mentioned cause. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you.

Dated this 15th day of May, 1942.

(Signed) J. P. WENCHEL,

RLW

Chief Counsel, Bureau of Internal Revenue, Counsel for  
Petitioner on Review.

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of error mentioned therein, is hereby acknowledged this 19 day of May, 1942.

COLUMBIA NATIONAL BANK

By JNO. D. ANKENY.

[Endorsed]: U. S. B. T. A. May 23, 1942. [23]

[Title of Circuit Court of Appeals and Cause.]

NOTICE OF FILING PETITION FOR  
REVIEW

To: John F. Watson, Esquire,  
First National Bank Building,  
Walla Walla, Washington.

You are hereby notified that the Commissioner of Internal Revenue did, on the 15th day of May, 1942, file with the Clerk of the United States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit of Appeals for the Ninth Circuit, of the decision of the Board heretofore rendered in the above-entitled cause. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you.

Dated this 15th day of May, 1942.

(Signed) J. P. WENCHEL,

RLW

Chief Counsel, Bureau of In-  
ternal Revenue, Counsel for  
Petitioner on Review.

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of error mentioned therein, is hereby acknowledged this 19th day of May, 1942.

JOHN F. WATSON.

Counsel for Respondent on  
Review.

[Endorsed]: U. S. B. T. A. Filed May 23. 1942.

[24]



[Title of Circuit Court of Appeals and Cause.]

NOTICE OF FILING PETITION FOR  
REVIEW

To: Thomas P. Gose, Esquire,  
Henry F. Moore, C. P. A.,  
809 Hoge Building,  
Seattle, Washington.

You are hereby notified that the Commissioner of Internal Revenue did, on the 15th day of May, 1942, file with the Clerk of the United States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Ninth Circuit, of the decision of the Board heretofore rendered in the above-entitled cause. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you.

Dated this 15th day of May, 1942.

(Signed) J. P. WENCHEL,

RLW

Chief Counsel, Bureau of Internal Revenue, Counsel for  
Petitioner on Review.

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of error mentioned therein, is hereby acknowledged this 19 day of May, 1942.

THOMAS P. GOSE,

Counsel for Respondent on  
Review.

[Endorsed]: U. S. B. T. A. Filed May 23, 1942.

[Title of Circuit Court of Appeals and Cause.]

NOTICE OF FILING PETITION FOR  
REVIEW

To: Thomas P. Gose, Esquire,  
Henry F. Moore, C. P. A.,  
809 Hoge Building,  
Seattle, Washington.

You are hereby notified that the Commissioner of Internal Revenue did, on the 15th day of May, 1942, file with the Clerk of the United States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Ninth Circuit, of the decision of the Board heretofore rendered in the above-entitled cause. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you.

Dated this 15th day of May, 1942.

(Signed) J. P. WENCHEL,

RLW

Chief Counsel, Bureau of Internal Revenue, Counsel for  
Petitioner on Review.

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of error mentioned therein, is hereby acknowledged this 18th day of May, 1942.

HENRY F. MOORE,

Counsel for Respondent on  
Review.

[Endorsed]: U. S. B. T. A. May 23, 1942. [26]

[Title of Circuit Court of Appeals and Cause.]

### STATEMENT OF POINTS

Now Comes Guy T. Helvering, Commissioner of Internal Revenue, the petitioner on review herein, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and hereby asserts the following errors on which he intends to rely in this review:

The Board of Tax Appeals erred:

1. In holding and deciding that no part of \$11,568.39 recovered by the taxpayer in 1939 on account of bad debt losses claimed and allowed as deductions from gross income in determining income tax liabilities for prior years should be included in the taxpayer's gross income for such year.

2. In failing to hold and decide that the amount of \$11,568.39 recovered by the taxpayer in 1939 on account of bad debt losses claimed and allowed as deductions from gross income in determining income tax liabilities for prior years constituted taxable income for the calendar year 1939.

3. In entering its decision wherein it ordered and decided that there is a deficiency in income tax due from this taxpayer of only \$13.14 for the calendar year 1939. [27]

4. In failing and refusing to enter its decision redetermining that there is a deficiency in income tax in the amount of \$1,921.92 for the calendar year 1939.



5. In that its decision is not supported by the evidence.

6. In that its decision is contrary to law and regulations.

(Signed) J. P. WENCHEL,

RLW

Chief Counsel, Bureau of Internal Revenue, Counsel for Petitioner on Review.

Service of a copy of the within statement of points is hereby admitted this 25th day of May, 1942.

JOHN F. WATSON,

THOMAS P. GOSE,

Counsel for Respondent on Review.

[Endorsed]: U. S. B. T. A. Filed Jun 8, 1942.

[28]

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[Title of Circuit Court of Appeals and Cause.]

### STATEMENT OF EVIDENCE

The above-entitled proceeding came on for hearing on September 9, 1941, before the Honorable John M. Sternhagen, Member of the United States Board of Tax Appeals. The petitioner appeared by its counsel, John F. Watson, Esquire, Thomas P. Gose, Esquire, and Henry F. Moore, C. P. A., and the respondent appeared by his counsel. Alva C. Baird, Esquire.

The proceeding was heard on stipulation of facts, oral testimony and documentary evidence. All of the oral testimony introduced which is material and necessary for the determination of the assignments of error set out by the petitioner on review in his petition for review by this Court of the decision of the Board of Tax Appeals is set out herein in narrative form.

### STATEMENT OF CASE ON BEHALF OF PETITIONER

Mr. Watson:

The petitioner seeks a redetermination of his income tax liability for the year 1939. The Commissioner claims a deficiency of \$1,921.92 for that year, based upon his including as taxable income \$11,568.39, bad debt recoveries during the year and which had been charged off in prior years. [29]

The respondent and petitioner have stipulated the facts as to the several charge-off years relative to the total charge-off and net loss of each year and particularly to various items covered in 1939 which the Commissioner seeks to tax.

It is also stipulated that during all of the years involved, the petitioner kept its books and accounts, made its Federal Income Tax Returns and paid its Federal Income Taxes on a cash basis, and not on an accrual basis. Consequently, our proof will be short and directed to two issues: The issue as to whether or not the petitioner had a tax benefit in a charge-off year on the recovery, which the Com-

missioner seeks to tax. The other issue would be the question as to whether the recovery which the Commissioner seeks to tax was a capital recovery. In other words, that the charge-off was out of the capital assets of the bank, and that when recovered, it would be a capital recovery.

STATEMENT OF CASE ON BEHALF OF  
RESPONDENT

Mr. Baird:

This taxpayer, during the years 1930 on to 1936 or 1937, according to its tax returns sustained losses. On those returns there were charged off the amounts which appear in the stipulation. We have not stipulated that the company sustained net losses because we don't know, but we have a stipulation as to what the returns will show. I assume Mr. Watson will supply testimony here to supply that link in the chain under his theory of the case.

We have stipulated as to what the recoveries were in 1939. It is simply a case of the bank having sustained losses in the prior years, [30] having charged off bad debts in those prior years and having received no tax benefits in those years.

Mr. Watson: We offer in evidence the income tax returns of the petitioner for the years 1930 to 1939, inclusive.

Mr. Baird: No objection.

The Court: Do you want those in as one exhibit?

Mr. Watson: Yes, your Honor.

The Court: Very well; Exhibit No.

(The documents referred to, Returns from 1930 to 1939, inclusive, were marked as Petitioner's Exhibit 1 and received in evidence.)

Mr. Baird: May an order be entered that we may withdraw these and substitute photostatic copies for these?

The Court: That may be done.

## EVIDENCE ON BEHALF OF PETITIONER

### GEORGE JACKSON,

called as a witness by and on behalf of the petitioner, having been first duly sworn, was examined and testified as follows:

#### Direct Examination

By Mr. Watson:

My name is George W. Jackson. I was connected with the Columbia National Bank during the years 1930 to 1939. Up to 1935 I was vice president and director and from that time on I have been a director. I had supervision of keeping of the accounts from 1930 up to 1935, inclusive. I signed the income tax returns for the years 1930 to 1935, inclusive. I think I prepared the returns myself. The data for the returns were taken from the original records of the bank. The 1930 return included a charge-off of \$98,674.20. [31]

Q. What were those charge-offs? What constituted the items of them?

A. They were notes charged off at the request of the National Bank Examiner.

(Testimony of George Jackson.)

Q. For what reason?

A. He said that they were not admissible as an asset for a national bank.

Q. Were they no good, or were they——

A. They were a loss. In the view of the National Banking Department, they were no good.

Q. What I am getting at, Mr. Jackson, is whether or not they were charged off as being improper loans, or whether they were worthless loans.

A. Worthless at the time.

Q. In other words, all of those charge-offs were regarded as worthless?      A. That is right.

Q. What were those loans made from?

A. They were made from the bank's funds.

Q. What happened when the loans were charged off? Did that impair the capital structure of the bank?

A. Yes, certainly. That is true of all these items.

Q. Is that true of the charge-offs shown in the returns for the ensuing years?      A. Yes sir.

Q. And they represent the same kind of loans? [32]      A. That is right.

Q. When I say "ensuing years," I mean not only the year 1930, but all of the years down to 1939.

A. That is right.

Q. I will ask you whether or not the petitioner bank had any tax benefits from the charge-offs of 1930 in that year. Is that shown by the return?

A. In 1930?

Q. Yes.



(Testimony of George Jackson.)

A. Well, they recovered \$13,289.10 that year.

Q. No. What I am getting at, Mr. Jackson, is this: What do those returns show, a net loss or a profit? Did you pay a tax that year?

A. No. We had losses of \$43,634.92 that year; that was the year's operation losses.

Q. These various loans that you have referred to as constituting the charge-off items, I will ask you whether or not they were made by the bank in the ordinary course of business. A. They were.

#### Cross-Examination

Mr. Baird:

Q. Mr. Jackson, what do you mean by your statement that the loans impaired the capital of the bank?

A. Any time we have a loss, it has to be charged somewhere to the capital structure.

Q. As a matter of fact, these loans were made in the usual course of business of the bank, were they not? [33] A. That is right.

Q. And made out of the funds that had been placed on deposit in the bank by depositors of the bank; isn't that right?

A. And stockholders.

Q. Well, deposits made by stockholders?

A. To the stockholders first, when we started the bank.

Q. Have you any further explanation as to that?

A. I don't know just what you mean.

Q. Well, I want the record to be clear that you are not attaching some peculiar significance to this

(Testimony of George Jackson.)

statement "paid out of capital." I am just trying to ascertain if there was something unusual about your transactions? A. No, there was not.

Q. These were loans made in the ordinary course of business of the banking business?

A. That is right.

Q. And made from amounts that were received by the bank from its depositors, stockholders, and others? A. Yes.

Mr. Baird: I think that is all.

The Court: Well, I don't think that is an answer to your question, made from "depositors, stockholders, and others." Do you mean they were made from the deposits on hand, irrespective of whether those deposits were made by stockholders or by others than stockholders? [34]

The Witness: The loans were made from the bank funds. The bank funds were an accumulation of capital stock and the depositors' money.

The Court: But none of these loans were earmarked as the source of the bank's funds from which the loans were made, were they?

The Witness: No.

The Court: You can't tell anything more about the source of the funds than appears on the ordinary financial statement of the corporation, can you?

The Witness: That is right.

The Court: If the corporation had deposits on hand sufficient for the loan, they made the loan, did they?



(Testimony of George Jackson.)

The Witness: That is right.

The Court: And did they make the loan as a customary matter? Did they make the loan even though they didn't have sufficient deposits on hand?

The Witness: No.

### Redirect Examination

Mr. Watson:

Q. When these charge-offs were made what, if anything, was required by the Treasury Department, the Comptroller's Office, of your bank with reference to your capital structure?

A. When an examination was made, the Examiner would go through the loans, and when he would get through, he would hand me a little slip with the necessary amount of charge-offs to be made, and that was set up in a statement which went to the Comptroller of the Currency, and the next time he came back, if they were not charged off—well, I don't know what would [35] happen then, because they were always charged off.

Q. In other words, you would follow directions?

A. I would follow directions, yes.

Q. Was it necessary, because of these charge-offs, for the bank to call upon its stockholders or anyone else to repair the capital?

A. Yes. I think it was in 1933 we levied a voluntary assessment.

Q. To repair the impairment?

A. The capital stock was impaired.

Q. It was impaired?

(Testimony of George Jackson.)

A. By these notes that were charged off.

Q. The charge-offs impaired the capital?

A. Yes.

Recross-Examination

Mr. Baird:

Q. It was also impaired by other reasons, was it not? That wasn't the only reason, was it? Wasn't there something else?

A. The losses were the only things that impaired it.

Q. Those were the only things?

A. Yes.

The Court: Were the losses that were directly attributable to the charge-off of loans, the only things that impaired your capital in 1933?

The Witness: Yes.

The Court: If you had not charged off the loans in 1933 which had been required by the Comptroller of the Currency's office, do I understand you to say that what you call your capital, would not have been impaired [36] and you would not have been required to levy an assessment upon the stockholders to make good the impaired capital?

A. That is right.

Mr. Baird: Mr. Watson, it will be stipulated, I believe, that there were no charge-offs made in 1933 with which we are concerned in this case. Under the stipulation there were no recoveries made of those debts, is that right?

(Testimony of George Jackson.)

Mr. Watson: Yes, that is correct. The stipulation will be that there were no charge-offs in 1933, included.

Mr. Baird:

Q. Mr. Jackson, with reference to the amounts which were charged off, did you have some loans that were charged off by the bank examiner because of the fact that the loans were improperly made under the banking regulations; that is, loans made to officers or loans made to people that the Bank Examiner would not authorize?

A. No, sir.

Q. In other words, are we to understand from your testimony that in each instance that the charge-off was made, it was made solely because of the loan that had been ascertained to have been worthless; is that correct?

A. That is right.

Q. And in no instance was there a charge-off then, as I understand it, simply because the loan did not conform to the banking regulations?

A. No other reason than it was a loss. [37]

By Mr. Watson:

Q. Mr. Jackson, is it not a fact that during these years that at some time the bank had to reduce its capital stock because of the charge-offs?

A. Yes.

Q. How much was that reduction?

A. \$50,000.

GLENN JACKSON,

called as a witness by and on behalf of the petitioner, having been first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Watson:

My name is Glenn Jackson. I have been cashier of the Columbia National Bank since January 1936. I succeeded Mr. George Jackson in the management of the bank. There was a cashier by the name of Bancroft ahead of me. As cashier, I have the supervision of the accounting and keeping of the books of the bank.

Q. Now, with reference to the charge-offs during the years you have been there, why were those charge-offs made?

A. By order of the National Bank Examiner.

\* \* \*

Q. I show you petitioner's income tax return for the year 1939, and I will ask you what were the total recoveries on these bad debts during that year.

Mr. Baird: Well, if your Honor please, the return itself has been stipulated to. [33]

Mr. Watson: I just don't want any confusion to arise. If the Court please, the return shows recoveries of some \$21,000; but the \$11,568.39 represents that portion of the recoveries that were claimed to be nontaxable. I didn't want the Court to get the idea, and I didn't want the record to be confused, that this does not represent all the recoveries of 1939, but only a part of them, the part we

(Testimony of Glenn Jackson.)

claim was nontaxable. I think we can clear that up by this witness.

By Mr. Watson:

Q. You testified as to the total recoveries for that year?

A. Yes, it was \$10,559.69.

Q. That is your total recoveries for that year?

A. That is what it shows here.

Q. I call your attention to the bad debt schedule attached to that return and ask you what that shows.

A. Just the bad debts that were charged off in that year.

Q. Well, is there anything about that return which shows any recoveries claimed as nontaxable? Look in the reconciliation on that.

A. Recoveries not taxable, \$11,568.39.

Q. Now, is that in addition to the recoveries on bad debts shown on the first page of the return?

A. Yes.

Q. Then, as a matter of fact, the bad debt recoveries for that year totaled the sum of those two?

A. That is right. [39]

Q. Now, with reference to the bad debt recoveries that you include as income, I will ask you why you included those as being taxable and why you didn't include the others?

A. Well, the ones that are shown as not taxable are those from which we received no benefit when they were charged off, and the ones that are taxable, we had.



(Testimony of Glenn Jackson.)

Q. Do you mean that the \$10,000 which you show on your 1939 return as being recoveries of bad debts which you include in your income for 1939 are the recoveries of debts which you had not only charged off, but deducted in prior years; is that right?

A. Yes.

The Court: And that the deductions of those debts in prior years served to reduce your tax?

The Witness: Yes.

The Court: What do you mean by tax benefit. Am I to understand that in regard to the \$11,000 which you did not include in your gross income for 1939, although you did recover that, that your failure to include them was due to the fact that, first, you say you did not receive any tax benefit in prior years?

The Witness: That is right.

The Court: Now, I ask you what you meant by the statement that you did not receive any tax benefit in prior years with regard to the \$11,000.

The Witness: That was due to the amount of the notes that were charged off in those years. [40]

The Court: Well, explain now just as fully as you can, what you mean when you say you didn't receive any tax benefit in prior years?

The Witness: Well, our losses exceeded our income by such an amount that we received no benefits from having made those charge-offs.

The Court: That is what you mean, is it.

The Witness: Yes.

(Testimony of Glenn Jackson.)

Cross-Examination

By Mr. Baird:

Q. Mr. Jackson, with reference to the years in which the charge-offs were made, would you have sustained a net loss, even if you had not made any charge-off on these particular debts?

A. Well, I don't know.

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EMMETT MALLAGHAN,

called as a witness by and on behalf of the petitioner, having been first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Watson:

My name is Emmett Mallaghan. I am engaged in the banking business. I am director of the Columbia National Bank of Dayton. I am also vice president and director of the First National Bank of Walla Walla, Washington. I know something about accounting, but to what extent, I would not say. I know how books are kept and how to check books. I prepared the return for the Columbia National Bank for 1939.

Q. I will ask you whether or not you have examined the original records of the bank and made any summary of the charge-offs and recoveries during these several years that are involved here. [41]



(Testimony of Emmett Mallaghan.)

A. I have.

Q. Is this it? (Counsel handed a paper to the witness.)

A. Yes. This is the summary of the charge-offs for each year, including 1930 to 1938, inclusive, and the recoveries made in those particular years.

Mr. Watson: I would like to offer this in evidence and I will give counsel a copy.

\* \* \* \* \*

By Mr. Watson:

Q. Referring to petitioner's income return for the year 1939, I call your attention to the fact that it reports as taxable income bad debt recoveries of \$10,559.69, and as nontaxable bad debt recoveries of eleven thousand and something—I don't know what those figures are there exactly. Will you explain those two figures?

A. Well, on the face of the return that shows the recoveries on bad debts of \$10,559.69, which were included in gross income. Now, my reason for including that amount for the aggregate of recoveries on notes which had been charged off in years when we had a tax to pay. We weren't questioning that, but through our summary, we have recovered in the year 1939, \$11,568.39. These items were charged off in years when we had shown a loss, the years '30 to '36, I think, inclusive. I do not recall that, but, at any rate, there were running, five or

(Testimony of Emmett Mallaghan.)

six years, in which we showed a loss due to charge-offs.

Q. So that the total bad debt recoveries in that year would be made up of both sums? [42]

A. Yes, twenty some odd thousand dollars, which were reported for tax purposes, and the ten thousand dollars, but excluded and carried over into the reconciliation section to balance our capital structure account, reporting that we had made these recoveries, but that our contention was they were not taxable, under the ruling that was in effect at that time.

Q. And these recoveries went where?

A. The recoveries went into the profit and loss account of the bank, which is a part of the capital structure, the idea being to restore for the past impairment of the capital structure.

The Court: What do you mean by capital structure?

The Witness: The capital structure of this bank is the subscribed capital contributed by the stockholders—the contributed surplus by the stockholders, and the earnings in previous years which, if distributed, would go to the stockholders. Our profit and loss cares for the particular year in which we are operating, the loss of anything charged against the undivided profits, and the gain, if any, added to the undivided profits, and being left by the stockholders in the bank with the bank as additional capital.

(Testimony of Emmett Mallaghan.)

The Court: But in speaking of the bank's capital, you are not confining that to capital stock and paid in surplus, are you?

The Witness: No, I am including the undivided profits.

The Court: Coming out of the surplus for prior years, or earnings for prior years?

The Witness: Being built by the earnings of prior years being left by the stockholders, instead of being withdrawn as dividends. [43]

#### Cross-Examination

By Mr. Baird:

Q. With reference to the debts making up the item of eleven thousand some odd hundred dollars, would you have sustained net losses in the years 1930 down to 1936, if those debts had not been charged off?

A. Had those particular debts been charged off, which makes up the aggregate of \$11,000, would not have kept the bank from paying taxes; but we charged off as capital in 1930, \$98,000, and showed a loss of some forty some thousand dollars. That, on its face, shows for the particular period in which we were operating, the year 1930, we made a profit from the operation of the bank; but through the charge-offs, we took a loss to the extent of \$43,000. We are not claiming that we didn't have benefits of the entire \$98,000; but we are claiming that we had benefits of only \$43,000, and that was reduced \$43.-

(Testimony of Emmett Mallaghan.)

000 through the actual operating earnings of the bank in that year.

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### EMMETT MALLAGHAN

was recalled as a witness by and on behalf of the petitioner and having been previously sworn, was examined and testified as follows:

#### Direct Examination

By Mr. Watson:

Q. I will ask you with reference to this document that has been offered in evidence, and which is still being offered, whether you have included in this summary, the taxable recoveries reported as such in the 1939 return.

A. The taxable recoveries?

Q. The taxable recoveries reported. [44]

A. As to nontaxable?

Q. You have only covered the nontaxable.

The Court: That is \$11,000.

The Witness: That is \$11,000, the idea being that any part of it brought up through 1938 was to give the effect that part of the loss had been recovered, leaving the balance remaining upon which there had been no tax benefits; and I have just referred to the items that we were claiming as the \$11,000.

#### Cross-Examination

By Mr. Baird:

Q. You have prepared a schedule under the heading of "Recoveries and Application thereof to the year of write-off" and then, in the third column

(Testimony of Emmett Mallaghan.)

from the left next to the last subdivision, you have a subheading "Total Recoveries by Year." I notice for the year 1939 you say the total recovery was \$11,568.39.

A. The total recovery was some \$20,000.

Q. That is the point I am making. You have a heading here showing total recoveries, and that, obviously, is not correct.

A. That could be an error, but——

Q. It is an error, isn't it?

A. But as far as I am concerned, my thought in the matter is that it is immaterial, because we are not claiming the \$9,000. We are trying to arrive at 1931, 1932, 1933, 1934, we have charge-offs, and due to those charge-offs, we had substantial losses. Now, we are trying to put before you the amount of the recoveries from the year 1931 on down to 1938, which [45] applies against the losses of those particular years. We admit on the face of our income tax return that \$9,000 of that is taxable income. Why try to drag that into the schedule? We are figuring out years in which losses occur. We are not figuring out years in which we deducted our losses and then afterward paid taxes. I can see your point, as far as——

\* \* \* \* \*

Q. I assume that when you prepare a schedule and give certain headings and make certain state-



(Testimony of Emmett Mallaghan.)

ments, that the language used means what it says.

A. Exactly.

Q. And when you say that the recoveries for these years are certain amounts, I assume that that is correct; and we know from the evidence that it is not correct. This schedule must be qualified in some way, or it is going to be confusing to the Board; it will not mean anything to anyone.

Mr. Watson: I think the testimony of the witness has qualified it so far as 1939 recoveries are concerned.

Mr. Baird: It may be that that will be sufficient.

#### Redirect Examination

By Mr. Watson:

Q. I will ask you, then as to whether the total recoveries of other years than 1939, as shown on this proposed exhibit, include the total recoveries, or only the part of the recovery which the petitioner claims to be nontaxable.

A. Just the nontaxable. The facts are that prior to 1930, we had always paid income tax on those collections, and those collections and charge-offs prior to 1930 are all taxable.

Mr. Baird: Referring to the claim which, for the purpose of identification, [46] I will mark double X in a circle so that we can tell what we are talking about, I will ask if the amounts written there under "Total Recoveries," contain recoveries other than those from which you maintain you had no tax benefit?

A. Yes.

Mr. Baird: They are limited solely to those re-

(Testimony of Emmett Mallaghan.)

coveries from which you gain no tax benefit?

Mr. Watson: In other words, the only year in which you don't include the taxable recoveries is the year 1939?

The Witness: Correct.

Mr. Watson: But as to all other years, you include both taxable and nontaxable recoveries?

The Witness: Yes, and the taxable all refers either to the year 1933, in which we filed an amended return and paid tax, or to years prior to 1930.

The Court: Now, as to every year, as I understand the last testimony, the exhibits shows, and from its face, it appears to show, that for every year except 1939, the items called "Recoveries," is the full item of bad debt recoveries, irrespective of what was done with those bad debts on the income tax return, isn't it?

The Witness: Yes.

The Court: But as to the year 1939, the item shown on the paper, although it is called "Total Recoveries," is not in fact total recoveries, but is only the recoveries which were or were not shown as income on the income tax return, which?

The Witness: It was the ones that were shown as not taxable on the income tax return. [47]

The Court: Now, am I correct in my understanding, then, that with the exception of the characterization of the amount of total recoveries in 1939, the exhibit is exactly in accordance with the books?



(Testimony of Emmett Mallaghan.)

The Witness: It is exactly in accordance with the books as I get the figures.

The Court: What do you mean by "as you get the figures"?

The Witness: I meant as taken from the——

The Court: And every other year except 1939, the words "Total Recoveries" used on the paper is in fact, total recoveries, isn't it, without regard as to whether they are identified as prior so-called tax benefits or charge-offs or not; is that right?

The Witness: Yes, that is correct.

The Court: And it is only with respect to 1939 that the words, "Total Recoveries" is not accurate; is that right?

The Witness: Yes, that is right.

The Court: Is the record clear now?

Mr. Baird: I think so, your Honor. I think it may be admitted, but I would like to make this reservation: That we are conceding that it may be admitted only for the purpose of this case. In other words, we made no audit of the books, and we don't want to be bound here by some other taxable years as to something that may be included by that schedule.

The Court: I can safely say that you will not be bound by some other taxable year. The exhibit is admitted.

(The document referred to, Summary Sheet, was marked as Petitioner's Exhibit No. 2 and received in evidence.) [48]

Keen ~~XX~~ ...

Year	Month	Day	Time	Location	Remarks
1950	7	16	10:00	...	...
1951	7	16	10:00	...	...
1952	7	16	10:00	...	...
1953	7	16	10:00	...	...
1954	7	16	10:00	...	...
1955	7	16	10:00	...	...
1956	7	16	10:00	...	...
1957	7	16	10:00	...	...
1958	7	16	10:00	...	...
1959	7	16	10:00	...	...
1960	7	16	10:00	...	...



The Court: You do not reserve any right that counsel be bound by any other taxable year, do you, Mr. Watson?

Mr. Watson: If the Court would permit it, I would not object; but I think it would be asking too much.

The Court: I think the record shows the circumstances under which the respondent is now refraining from objecting to this exhibit.

Mr. Watson: Yes.

The Court: And I think in that stage of the record, and this being a public record, there is no chance of there being any doubt as to whether the petitioner will attempt to hold the respondent as to the accuracy as to something that may show up in another case. Now, have you any further evidence, Mr. Watson?

Mr. Watson: No, your Honor.

The Court: The exhibit is received.

\* \* \* \* \*

The foregoing was all of the material testimony offered on behalf of petitioner in this cause. Thereupon, counsel for petitioner and counsel for respondent stated that they had no further evidence to present and submitted the cause to the Member of the Board of Tax Appeals hearing the proceedings.

The foregoing is the substance of all the evidence adduced at the trial of said proceeding and the Commissioner of Internal Revenue tenders and presents the foregoing as a statement of the evidence in the cause and prays that the same be approved

by the United States Board of Tax Appeals and made a part of the record in this cause.

(Signed) J. P. WENCHEL,

RLW

Chief Counsel, Bureau of Internal Revenue. [49]

The above and foregoing statement of evidence contains the substance of all the evidence material for a review of the rulings and decision assigned as error herein and the same may be approved by the Board without notice.

JOHN F. WATSON,

THOMAS P. GOSE,

Counsel for Respondent on Review.

[Endorsed]: U. S. B. T. A. Jun. 8, 1942. [50]

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[Title of Board and Cause.]

**CERTIFICATE OF CLERK TO TRANSCRIPT  
OF RECORD**

I, B. D. Gamble, clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 159, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praeceptum in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax

Appeals, at Washington, in the District of Columbia, this 12th day of June, 1942.

[Seal]

B. D. GAMBLE

Clerk,

United States Board of Tax  
Appeals.

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[Endorsed]: No. 10167. United States Circuit Court of Appeals for the Ninth Circuit. Commissioner of Internal Revenue, Petitioner, vs. Columbia National Bank, a corporation, Respondent. Transcript of the Record. Upon Petition to Review a Decision of the United States Board of Tax Appeals.

Filed June 16, 1942.

PAUL P. O'BRIEN,

Clerk of the United States Circuit Court of Appeals  
for the Ninth Circuit.



In the United States Circuit Court of  
Appeals for the Ninth Circuit

No. 10167

GUY T. HELVERING, Commissioner of Internal  
Revenue,

Petitioner on Review,

vs.

COLUMBIA NATIONAL BANK,

Respondent on Review.

PETITIONER'S DESIGNATION OF THE  
PARTS OF THE RECORD TO BE PRINTED

To the Clerk of the United States Circuit Court of  
Appeals for the Ninth Circuit:

Guy T. Helvering, Commissioner of Internal Revenue, the petitioner on review herein, by his attorneys, Samuel O. Clark, Jr., Assistant Attorney General, and J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, pursuant to his petition for review of the decision of the United States Board of Tax Appeals entered February 26, 1942, designates the parts of the record considered material to the questions on review to be included in the printed transcript of the record, as follows:

1. Docket entries of all proceedings before the Board.
2. Pleadings before the Board:
  - (a) Second Amended Petition, includ-

ing copy of deficiency letter (Exhibit A) and Exhibit B, attached.

(b) Answer to Second Amended Petition.

3. Stipulation of Facts, including Exhibit A, attached.

4. Memorandum Opinion and Decision.

5. Petition for Review, together with proof of service of notice of filing and of service of a copy of petition for review.

6. Statement of Evidence, with Petitioner's Exhibit 2.

7. Statement of Points.

8. Petitioner's Designation of the Parts of the Record to be Printed.

SAMUEL O. CLARK, JR.,  
Assistant Attorney General.  
J. P. WENCHEL,  
Chief Counsel,  
Bureau of Internal Revenue,  
Counsel for Petitioner on  
Review.

Service of a copy of the within designation is hereby admitted this 28th day of May, 1942.

JOHN F. WATSON  
THOMAS P. GOSE

Counsel for Respondent on  
Review.

[Endorsed]: Filed Jun. 17, 1942. Paul P. O'Brien,  
Clerk.

